# 18. MALTA

## Economic activity to remain robust

*Malta's economic growth has settled down from the exceptional levels of 2014 and 2015 but is forecast to remain well above the EU average. Unemployment is set to remain at record lows while productivity gains contain unit labour costs and preserve competitiveness. The budget deficit is only expected to improve marginally, however, as growing tax revenues are largely offset by rising expenditure.*

In December 2016, annual real GDP growth for 2014 and 2015 was revised upwards to reach an average annual rate of 7.9% - the highest since EU accession. The revisions, which reflected additional information from the regular structural business surveys as well as the gaming sector, affected mainly external trade data, particularly service exports. As a result, net exports became the main driver of growth in 2014 and had a more moderate negative effect on growth in 2015. The revisions confirmed that investment was the main growth engine in 2015, largely boosted by one-off factors. On the supply side, professional services and gaming made the strongest contribution to the expansion of gross value added over these years.

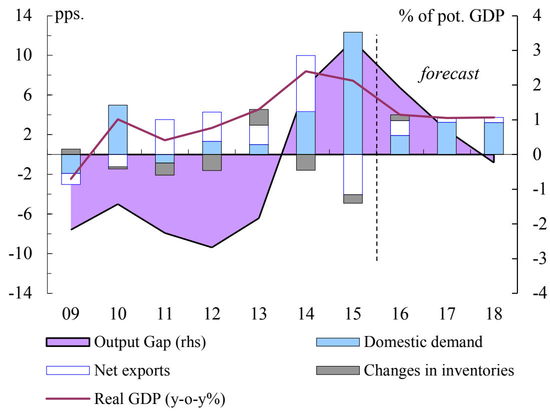
### Economy settling down gently

Economic activity expanded by 3.9% in the first three quarters of 2016, compared to the same period in 2015. Meanwhile, investment contracted, compared to its extraordinary levels in 2015, in particular in non-residential construction and machinery and equipment. As imports subsided concomitantly, private consumption and net exports took over as the main engines of growth. Available confidence indicators give no reason to expect a slowdown in the final quarter of the year. As a result, real GDP growth is estimated to have turned out at 4.0% in 2016.

### Growth seen becoming more self-sustaining

The economic expansion is forecast to continue at a broadly unchanged pace in 2017 and 2018. Private consumption is projected to continue growing robustly, supported by favourable labour market developments. Fiscal policy is set to remain accommodative, while improving financing conditions are set to contribute to the recovery in investment. The current-account is forecast to stabilise at a surplus of over 5% of GDP. Given Malta's high trade openness, shocks to global trade could have a disproportionate impact on the domestic economy. The successful launching of the Malta Development Bank could lead to more dynamic investment in the medium term. Meanwhile, effective implementation of ongoing structural reforms could boost domestic demand and further support growth prospects going forward.

*Graph II.18.1:* **Malta - Output gap and contributions to real GDP growth**




### Favourable labour market conditions continue

Net job creation in 2016 is expected to have been robust thanks at least in part to the implementation of activation policies by the government. It is forecast to have outpaced the expansion of the labour force, sending the unemployment rate to below 5%. Unemployment is set to remain broadly unchanged over the forecast horizon, close to the structural rate. Skills shortages are expected to put pressure on wage growth. With productivity rising at the same time, however, unit labour cost increases are projected to remain contained.

Consumer price inflation moderated in 2016 in particular due to prices of recreation and cultural services. It is projected to pick up moderately over the forecast horizon but to remain below the long-term average.

### Budget deficit broadly stable over the forecast horizon

In 2016, the general government deficit is estimated to have decreased to 0.7% of GDP, from 1.4% in 2015. Current revenue is expected to have grown more than nominal GDP, due to the favourable macroeconomic environment as well as the proceeds from the citizenship programme and the rise in excise duties. Current expenditure is expected to have continued growing, mainly driven by increases in public sector wages and intermediate consumption, which included costs associated with Malta's presidency of the EU. Despite the sharp decline in the absorption of EU funds, due to the beginning of a new programming period, and a lower capital injection into the national airline, net capital expenditure is expected to increase by 0.2 pps. of GDP.

In 2017, the deficit is expected to decline marginally to 0.6% of GDP. Despite a boost to tax revenue by the introduction of revenue increasing measures in the 2017 budget, current revenue is expected to grow slower than nominal GDP due to lower proceeds from the citizenship scheme. Current expenditure growth is also expected to moderate, mainly thanks to lower interest expenditure and a more moderate increase in social spending. On the contrary, higher intermediate consumption and other current expenditure are set to boost the growth rate of the total current expenditure. Net public investment is expected to decrease by 0.2 pps. of GDP due to greater implementation of investment projects co-financed by the EU. In 2018, under a no-policy-change assumption, the deficit is expected to remain stable even as revenues linked to the citizenship programme continue to fall. Potential expenditure overruns could come from a renewal of the public sector wage agreement.

Risks to the fiscal outlook for 2016 are on the upside, as income tax receipts may still lower the 2016 deficit. For 2017-18, risks are balanced overall, as slippages in current expenditure, mainly related to intermediate consumption and the renewal of the wage agreement (which expired at end-2016), could be compensated by higher proceeds from the citizenship programme.

Thanks to a swift closure of the positive output gap, the structural deficit is projected to be on a declining path and to improve by more than 2 pps. of GDP by 2018. From 60.8% in 2015, the debt-to-GDP ratio is projected to fall below 60% in 2016 and to reach 55.6% by 2018.

*Table II.18.1:*

**Main features of country forecast - MALTA**

| | | 2015 | | Annual percentage change | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | mio EUR | Curr. prices | % GDP | 97-12 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
| GDP | | 9250.3 | 100.0 | 2.7 | 4.6 | 8.4 | 7.4 | **4.0** | **3.7** | **3.7** |
| Private Consumption | | 4665.0 | 50.4 | 2.2 | 2.2 | 2.6 | 5.5 | **3.6** | **2.8** | **2.7** |
| Public Consumption | | 1696.3 | 18.3 | 1.9 | 0.1 | 7.0 | 4.7 | **3.2** | **7.5** | **6.2** |
| Gross fixed capital formation | | 2307.1 | 24.9 | 1.4 | -1.7 | 8.8 | 49.8 | **-2.0** | **2.0** | **3.1** |
| of which: equipment | | 1255.8 | 13.6 | - | -5.0 | 15.1 | 121.3 | **-** | **-** | **-** |
| Exports (goods and services) | | 13264.6 | 143.4 | 5.7 | 1.0 | 5.1 | 4.3 | **1.5** | **3.7** | **3.9** |
| Imports (goods and services) | | 12538.4 | 135.5 | 4.9 | -0.2 | 1.5 | 7.7 | **0.5** | **3.6** | **3.7** |
| GNI (GDP deflator) | | 8865.1 | 95.8 | 2.4 | 3.8 | 8.6 | 8.0 | **4.3** | **4.0** | **4.0** |
| Contribution to GDP growth: | Domestic demand | | | 2.1 | 1.0 | 4.3 | 12.4 | **2.0** | **3.3** | **3.3** |
| | Inventories | | | -0.2 | 1.5 | -1.5 | -0.8 | **0.5** | **0.0** | **0.0** |
| | Net exports | | | 0.8 | 1.9 | 5.6 | -4.2 | **1.5** | **0.4** | **0.5** |
| Employment | | | | 1.0 | 3.7 | 5.1 | 3.5 | **3.0** | **2.8** | **2.6** |
| Unemployment rate (a) | | | | 6.8 | 6.4 | 5.8 | 5.4 | **4.8** | **4.9** | **4.9** |
| Compensation of employees / head | | | | 3.8 | 2.0 | 1.4 | 3.8 | **3.0** | **2.9** | **2.8** |
| Unit labour costs whole economy | | | | 2.1 | 1.2 | -1.6 | 0.0 | **2.0** | **2.0** | **1.7** |
| Real unit labour cost | | | | -0.2 | -0.7 | -3.4 | -2.1 | **0.3** | **-0.1** | **-0.6** |
| Saving rate of households (b) | | | | - | - | - | - | **-** | **-** | **-** |
| GDP deflator | | | | 2.4 | 1.9 | 1.9 | 2.2 | **1.7** | **2.1** | **2.4** |
| Harmonised index of consumer prices | | | | 2.7 | 1.0 | 0.8 | 1.2 | **0.9** | **1.6** | **1.8** |
| Terms of trade of goods | | | | 0.2 | 1.7 | 6.6 | 1.1 | **1.4** | **-0.1** | **0.0** |
| Trade balance (goods) (c) | | | | -16.2 | -13.4 | -12.3 | -19.3 | **-18.0** | **-18.6** | **-18.7** |
| Current-account balance (c) | | | | -3.9 | 3.1 | 9.6 | 5.2 | **5.0** | **5.3** | **6.0** |
| Net lending (+) or borrowing (-) vis-a-vis ROW (c) | | | | -2.8 | 4.9 | 11.2 | 7.0 | **6.7** | **6.9** | **7.4** |
| General government balance (c) | | | | -4.9 | -2.6 | -2.0 | -1.3 | **-0.7** | **-0.6** | **-0.6** |
| Cyclically-adjusted budget balance (d) | | | | -4.8 | -1.8 | -2.9 | -2.8 | **-1.6** | **-0.9** | **-0.5** |
| Structural budget balance (d) | | | | - | -1.9 | -3.4 | -2.9 | **-1.4** | **-0.7** | **-0.5** |
| General government gross debt (c) | | | | 64.0 | 68.7 | 64.3 | 60.8 | **59.6** | **58.0** | **55.6** |

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.